

Message Text

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ACTION EUR-12

INFO OCT-01 EA-06 ISO-00 AID-05 CEA-01 CIAE-00 COME-00

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TO SECSTATE WASH DC 5576

AMEMBASSY WELLINGTON

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E.O. 11652: N/A

TAGS: ECON, OECD

SUBJECT: FIRST EDRC REVIEW OF NEW ZEALAND, MARCH 4

REF: OECD DOCUMENT EDR(75)4

1. SUMMARY: EDRC WILL HOLD FIRST REVIEW OF NEW ZEALAND ECONOMY ON MARCH 4. MAIN ISSUES FOR DISCUSSION WILL BE PROBLEMS OF INFLATION AND BALANCE OF PAYMENTS. NEW ZEALAND DELEGATES WILL BE ASKED TO COMMENT ON (A) LIMITS POSED BY B/P DEFICIT AND RAPID INFLATION TO DEMAND POLICY ACTION AIMED AT SUSTAINING LEVELS OF ACTIVITY; (B) DOMESTIC AND EXTERNAL FACTORS RESPONSIBLE FOR RECENT PRICE ACCELERATION, ESPECIALLY EFFECTS OF 1974 DEVALUATION; (C) POSSIBILITIES FOR HOLDING LINE ON SIZE OF INCREASE ALLOWED IN GOVERNMENT'S WAGE ADJUSTMENT ORDER DUE IN JULY. ON BALANCE-OF-PAYMENTS SIDE, THEY WILL BE ASKED TO ASSESS FOREIGN TRADE OUTLOOK AND PROSPECTS FOR FINANCING CURRENT ACCOUNT DEFICIT, AS WELL AS PROSPECTS FOR DEVELOPING MORE DIVERSIFIED EXPORT BASE OVER LONGER TERM. ACTION REQUESTED: WOULD APPRECIATE ANY COMMENTS

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OR QUESTIONS WHICH DEPARTMENT AND EMBASSY WELLINGTON

CAN PROVIDE IN TIME FOR ANNUAL REVIEW.
END SUMMARY.

2. OUTLOOK FOR 1975: SECRETARIAT NOTES SUSCEPTIBILITY OF NZ DOMESTIC ECONOMY TO EXTERNAL INFLUENCES AND UNUSUAL DEGREE OF UNCERTAINTY REGARDING EXTERNAL DEMAND FROM MAJOR TRADING PARTNERS THIS YEAR. SECRETARIAT SEES REAL GROWTH OF GNP SLOWING TO ABOUT 2.5 PERCENT IN 1975, WITH ALL MAJOR COMPONENTS OF PRIVATE DOMESTIC DEMAND EXPECTED TO WEAKEN MARKEDLY AND MAIN SUPPORT COMING FROM IMPROVEMENT OF EXTERNAL BALANCE (LARGELY ON IMPORT SIDE). CONSUMER EXPENDITURE FORECAST RISE ONLY SLIGHTLY; PRIVATE INVESTMENT EXPECTED TO DECLINE SHARPLY BY ABOUT 10 PERCENT IN VOLUME TERMS. PUBLIC EXPENDITURE SEEN INCREASING BY ABOUT 5 OR 6 PERCENT. TOTAL DOMESTIC DEMAND MAY THEREFORE DECLINE BY AROUND 2 PERCENT IN REAL TERMS IN FY 1975/76. UNEMPLOYMENT IS EXPECTED TO INCREASE FURTHER DURING COURSE OF YEAR, BUT PERHAPS AT LESSER RATE BECAUSE OF SLOWER GROWTH OF LABOR FORCE RESULTING FROM 1974 RESTRICTIONS ON IMMIGRATION.

3. OUTLOOK FOR PRICES AND WAGES: SECRETARIAT SEES NO EARLY ABATEMENT OF PRESENT INFLATIONARY TRENDS (CPI NOW RISING AT ANNUAL 12-14 PERCENT). ON WAGE FRONT, SECRETARIAT SEES CONSIDERABLE PRESSURE BUILDING UP, BUT GIVEN OFFICIAL WAGE CONTROL AUTHORITY MID-YEAR NEGOTIATIONS MAY BE SUBJECT TO GOVERNMENT LIMITATIONS ON SCOPE FOR FREE BARGAINING. IN ADDITION TO WAGE PUSH EFFECTS ON INFLATION, SECRETARIAT NOTES THAT RESULTS OF SEPTEMBER 1974 DEVALUATION ARE STILL LARGELY IN PIPELINE AND MAY RESULT IN SIGNIFICANT INCREASE IN PRICES OF IMPORTED GOODS. SECRETARIAT BELIEVES THAT GNZ HAS NO CHOICE BUT TO MAINTAIN PRESENT SYSTEM OF DIRECT CONTROLS OVER BOTH PRICES AND WAGES, ALTHOUGH SOME RELAXATION OF PRICE CONTROLS MAY BE NECESSARY TO OFFSET EXPECTED DETERIORATION IN COMPANY PROFITABILITY.

4. BALANCE-OF-PAYMENTS OUTLOOK: SECRETARIAT FORECASTS SLIGHT IMPROVEMENT IN CURRENT ACCOUNT DEFICIT TO ABOUT 6.5 TO 7 PERCENT OF GNP DURING FY 1975/76, COMPARED WITH LIMITED OFFICIAL USE

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ESTIMATED DEFICIT OF 9.5 PERCENT OF GNP IN FY 1974/75. IN VOLUME TERMS, EXPORTS LIKELY TO REMAIN STABLE DUE TO COMBINATION OF BETTER PROSPECTS FOR DAIRY EXPORTS AND WORSE PROSPECTS FOR WOOL AND BEEF, WHILE VOLUME OF IMPORTS EXPECTED TO FALL SHARPLY (BY CLOSE TO 12 PERCENT) AS RESULT DEPRESSED LEVELS OF DOMESTIC ACTIVITY. THIS IMPROVEMENT IN VOLUME TERMS WILL BE LARGELY OFFSET, HOWEVER, BY EXPECTED CONTINUED DETERIORATION

IN TERMS OF TRADE FOR REMAINDER OF 1975.

5. POLICY CONCLUSIONS: SECRETARIAT BELIEVES PRIORITY SHOULD BE GIVEN TO REDUCING CURRENT ACCOUNT DEFICIT AND RATE OF INFLATION. IT CONSIDERS PRESENT MILDLY

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RESTRICTIVE STANCE OF DEMAND MANAGEMENT POLICY TO BE APPROPRIATE, BUT BELIEVES SOME SELECTIVE EMPLOYMENT-GENERATING SCHEMES MAY BE NECESSARY TO CUSHION FURTHER WEAKENING IN LABOR MARKET. SECRETARIAT NOTES THAT PRESENT FARM INCOME STABILIZATION PLAN IS ONLY TEMPORARY, AND BELIEVES MORE FAR-REACHING AND PERMANENT SCHEME WOULD BE DESIRABLE TO ASSIST IN OVERCOMING DIFFICULTIES CAUSED BY FLUCTUATING EXPORT PRICES FOR FARM PRODUCTS. SUCH SCHEME SHOULD TAKE PRIORITY IN GOVERNMENT PLANNING OVER INVESTMENT SUBSIDIES TO ENCOURAGE DECENTRALIZATION OF INDUSTRY.

6. STRUCTURAL PROBLEMS: SECRETARIAT BELIEVES THAT

CURRENT MONETARY POLICY AIMED AT MAINTAINING LOW
INTEREST RATES AND RELIANCE ON DIRECT CREDIT CONTROLS
PERMITS INSUFFICIENT FLEXIBILITY FOR RESPONDING TO
CONJUNCTURAL REQUIREMENTS. MORE ACTIVE USE OF INTEREST-
RATE POLICY WOULD NOT ONLY HELP ATTAIN DEMAND-MANAGEMENT
OBJECTIVES BUT ALSO MIGHT CONTRIBUTE TO THE DEVELOPMENT
OF COUNTRY'S FINANCIAL MARKETS.
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7. SECRETARIAT ALSO IDENTIFIES PROBLEM OF LAGGING
GROWTH RATE WHICH IT SEES AS BEING LARGELY ATTRIBUTABLE
TO (A) IMPORT PROTECTION SCHEMES FOR DOMESTIC INDUSTRIES
DESIGNED TO ASSURE FULL EMPLOYMENT; (B) INSTABILITY
IN LEVELS OF ECONOMIC ACTIVITY RESULTING FROM
FLUCTUATIONS IN EXTERNAL DEMAND AND PRICES; AND
(C) INEFFICIENT USE OF CAPITAL DUE TO SMALL SIZE OF
PRODUCTIVE UNITS IN INDUSTRY AND AGRICULTURE.
SECRETARIAT WOULD LIKE TO SEE BROAD-SCALE REVIEW OF
PRESENT SYSTEM OF INDUSTRIAL PROTECTION WITH VIEW TO
REPLACING EXISTING QUANTITATIVE CONTROLS WITH TARIFFS,
AND ULTIMATELY BRINGING ABOUT STRUCTURAL SHIFTS TO
REFLECT MORE APPROPRIATE ALLOCATION OF RESOURCES. ON
EXTERNAL SIDE, SECRETARIAT STRESSES NEED FOR GREATER
DIVERSIFICATION OF EXPORTS IN ORDER TO REDUCE
SENSITIVITY TO FLUCTUATIONS IN EXPORT RECEIPTS. GIVEN
SMALL-SCALE NATURE OF NEW ZEALAND INDUSTRY, EXPORT
DIVERSIFICATION MAY REQUIRE SUBSTANTIAL INFLOWS OF
LONG-TERM CAPITAL FROM ABROAD.

8. ADVANCE COPIES OF REFDOCS HAND-CARRIED FEBRUARY 2L
TO CLARK, EUR/RPE AND AIRMAILED TO EMBASSY WELLINGTON.
ACTION REQUESTED: ESPECIALLY SINCE THIS WILL BE
FIRST REVIEW OF NEW ZEALAND BY EDRC, MISSION WOULD LIKE
TO CONTRIBUTE TO DISCUSSION IN SUBSTANTIVE WAY AND
WOULD APPRECIATE RECEIVING QUESTIONS AND COMMENTS FROM
DEPARTMENT AND EMBASSY WELLINGTON.
TURNER

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